SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1956

No. ~~[illegible]~~ 95

HOOVER MOTOR EXPRESS CO., INC.,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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Petitioner, Hoover Motor Express Co., Inc., a Tennessee Corporation engaged in business as a motor carrier of freight, pursuant to certificates of convenience and necessity issued by the Interstate Commerce Commission prays that the Writ of Certiorari issue to review a decision of the United States Court of Appeals for the Sixth Circuit which held that Petitioner could not deduct as an operating expense for income tax purposes fines paid to various states because its trucks had in some way exceeded the weight limitations fixed by state statute. In the vast majority of instances in which fines were imposed the entire vehicle was within the permissible weight limitations, but the weight on one axle was excessive, usually because of some shifting of freight during transit. The Court of Appeals held that said sums were not deductible even though

none of the violations of the weight laws was wilful and none resulted from the failure of Petitioner to take every precaution which could fairly be demanded of it.

Opinions Below

The opinion of the Court of Appeals which affirmed the opinion of the District Court for the Middle District of Tennessee was entered on January 4, 1957 and is copied in the Appendix hereto at page 12.

The opinion of the District Court is reported in 135 Fed. Supp. 818, and is copied in the Appendix hereto at page 13.

Jurisdiction

The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

The District Court is given jurisdiction by Sec. 1346 Title 28, U. S. C.

Questions Presented

1. Whether a common carrier of freight by motor vehicle may deduct as an operating expense for income tax purposes overweight fines which it has paid to the states where the violations of the State Weight laws were not wilful and the carrier took every precaution that could fairly be demanded to comply with the State Weight laws.

2. Whether a lawful business which incurs an item of expense which cannot be avoided by the exercise of ordinary and reasonable care is entitled to deduct such expense in computing its income tax even though such expense is denominated as a fine or penalty.

Statute Involved

The applicable statute is Section 23(a)(1)(A) of the Internal Revenue Code, which provides:

> "In computing net income there shall be allowed as deductions . . . all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or busines. . ."

Statement of the Case

Petitioner is a common carrier of freight by motor vehicle certificated by the Interstate Commerce Commission. It is authorized to and does transport freight to and from points in Georgia, Alabama, Tennessee, Kentucky, Missouri and Ohio.

All of the states through which Petitioner operates have statutes limiting the size and weight of trucks. These statutes vary in some respects, but all fix maximum weight for an entire vehicle. They also fix the maximum weight for each axle so that frequently a vehicle is within the maximum allowance for the entire vehicle but, at the time of weighing by representatives of a state, one axle is carrying too much of the overall weight so that an axle violation results. As found by the Courts in this case, this situation usually results from some shifting of cargo during transit.

On September 10, 1942 the Commissioner of Internal Revenue by express ruling held that overweight fines paid by motor carriers were deductible under Section 23 of the Revenue Act above quoted. A subsequent ruling by a different Commissioner was issued effective November 30, 1950, which reversed the prior ruling.

Upon audit of Petitioner's tax returns for the taxable years 1951-1953, inclusive, fines paid during those years

were disallowed as a deductible expense and additional tax and interest was assessed against Petitioner based upon such disallowance. Petitioner paid the tax and interest and filed claims for refund, which were denied, and thereupon Petitioner filed this suit in the District Court for the recovery of the tax and interest attributable to the disallowance of the overweight fines.

Upon the trial of the case, Petitioner offered proof to show that no violation of any of the weight laws was wilful and that it took every precaution which it could reasonably take to insure compliance with the statutes of all states.

The District Court in its opinion, which was adopted by the Court of Appeals, in denying recovery stated:

> "It appears that the fines paid by the plaintiff for the taxable years resulted in large measure, probably in the vast majority of instances, because one or more axles of the vehicle involved carried weight in excess of the per axle limitation imposed by the various states, although in these instances the vehicle with its load of freight was within the overall weight limitations. The proof shows that such violations usually occurred because of a sifting of the freight within the vehicle during transit."
>
> "* * * Assuming that it took every precaution that could fairly be demanded consistent with a practical operation of its business, and assuming further that it did not act with wilful intent, the Court is of the opinion that to allow the claimed deductions from gross income for the taxable years would nevertheless frustrate the clearly defined policies of the applicable state weight limitation laws."

Reasons for Granting the Writ

1. The decision of the Court of Appeals in this case is in conflict with a decision of the Court of Appeals for the Second Circuit in the case of *Rossman Corp. vs. Commissioner*, 175 F.2d 711. In the *Rossman* case the Court in construing the decision of this Court in the case of *Commissioner vs. Heininger*, 320 U.S. 467, 64 S.Ct. 249, 88 L. Ed. 171, held that "there are 'penalties' and 'penalties', and that some are deductible and some are not." (page 713). The Court also held that penalties were deductible if violations which resulted in imposition of penalty were not wilful; and the taxpayer had exercised proper care in endeavoring to comply with the act involved and that the allowance of such a deduction would not "frustrate" the act.

In the case now before the Court; the Court of Appeals held that the fact that the Petitioner did not act with wilfull intent and did take all reasonable precautions was wholly immaterial. Under this reasoning no penalty would ever be deductible, contrary to the ruling of the Court in the Rossman case that some penalties are deductible.

2. The Court of Appeals in this case has decided an important question of Federal law which has not been, but should be settled by this Court.

Since Section 23 (a) of the Revenue Act makes no reference to the lawful or unlawful character of the expenses which are deductible, this Court should determine whether there is any difference between wilful or negligent violation of statuts and non-wilfull and non-negligent violations in applying the judicial doctrine of disallowing such fines and penalties.

3. The decision of the Court of Appeals makes an improper and erroneous legal conclusion from the assumed facts. If Petitioner has taken every precaution that could fairly be demanded and it did not act with wilful intent,

the allowance or disallowance of the deduction could have no bearing whatever on future violations and, therefore, the allowance of the deduction could not frustrate the defined policies of state laws.

4. The decision of the Court of Appeals results in unequal taxation because it disallows, as a deduction, an expense of doing business which, from the assumption of facts upon which the decision is based, cannot be avoided in the particular lawful business in which Petitioner is engaged.

Argument

There are a number of cases from lower Federal Courts dealing with the right to deduct, as an operating expense, fines or penalties. In this regard, the Court of Appeals for the Second Circuit in the case of *Rossman Corp.* vs. *Commissioner*, 175 F. 2d 711, at page 713, stated:

> "The Revenue Act does not declare that penalties may not be deducted; the doctrine is a judicial gloss—and, for that matter, a gloss of the lower courts only, save as the Supreme Court recognized it by implication in Commissioner v. Heininger."

In *Commissioner* vs. *Heininger*, 320 U.S. 467, 64 S.Ct. 249, 88 L. Ed. 171, referred to in the *Rossman* case above quoted, this Court, in recognizing this "judicial gloss", cited in footnote 8 several cases. The facts in each case involved fines or penalties which resulted from violations of statutes which were of necessity either wilful or the result of negligence.

One of the cases cited is that of *Burroughs Building Material Co.* vs. *Commissioner* (CCA 2d), 47 F. 2d 178. In that case the question presented involved the deductibility of fines which resulted from violations of statutes prohibiting price fixing, and these violations of necessity were wilful. While the Court held against the taxpayer, in the course of opinion it stated at page 180:

> "Undoubtedly expenditures which are in themselves immoral, such as bribery of public officials to secure protection of an unlawful business, would not have to be allowed in order consistently to justify a deduction of fines paid for violations of law involving no moral turpitude and practically inevitable."

In the *Rossman* case decided by the same Court (CCA2), when presented squarely with the question, the Court held that a determination of whether the violations were wilful or negligent as opposed to non-wilful and non-negligent was material in deciding whether fines or penalties were deductible. In so doing the Court, speaking through Chief Judge Learned Hand, in referring to the decision of this Court in the *Heininger* case, stated at page 713:

> "On the other hand, it is also possible to read it (the Heininger case) as meaning that, whether the claimed deduction be of legal expenses or of fines or forfeitures, its allowance depends upon the place of sanctions in the scheme of enforcement of the underlying act. We think that the second is the right reading; in short that there are "penalties" and "penalties", and that some are deductible and some are not."
>
> "Perhaps the deduction of a fine or forfeiture after an "administrative finding of guilt," is more likely to "frustrate" the "sharply defined policies" of a statute which imposes it, than the deduction of the legal expenses of an unsuccessful defence—though that seems questionable—*but certainly there is no more ground for taking as "a rigid criterion" the imposition of the fine than the incurrence of the expenses.* Each may "frustrate the sharply defined policies" of a statute; that will depend upon how one views their deterrent effect. *We hold therefore that in every case the question must be decided ad hoc.*" (Emphasis added)
>
> "One may indeed argue, as the Commissioner does, that the more unsparing and relentless was the pursuit of offenders, however innocent they may have been of any wilful violation of the regulations, the more solicitous would they become to comply, and the more effec-

tive would be the enforcement of the Act. That has been a school of penology since the time of Draco; but it has not been the only school, and, as we read Commissioner v. Heininger, supra, the Supreme Court did not accept it."

The Court also recognized the importance of proper care in endeavoring to comply with the statute involved and at least inferred that before the allowance of the deduction could "frustrate" the Act there must be a finding of lack of due care. In this respect the Court stated (page 714):

> "On the other hand, lack of proper care would be relevant to * * * whether the allowance would "frustrate" the Act."

This Court judicially knows that the Interstate Commerce Commission regulates the rates which common carriers may charge for their services, and all expenses of transportation are material in determining proper charges. It is, therefore, most important to the proper regulation of rates of motor carriers for the Interstate Commerce Commission, as well as carriers, to have this Court rule expressly on the questions squarely presented in this case. If States impose unavoidable costs to carriers and elect to denominate such costs as fines when, from a practical standpoint the payments are clearly remedial, the entire earnings of a common carrier can be completely absorbed by this element of expense because it has to be paid entirely from net income after taxes. This is certainly a very harsh burden to place upon a legitimate business when it is doing everything it can reasonably be expected to do to operate in a lawful manner and to perform the service for the public which it is legally obligated to perform. The allowance of the deductions in this case could not frustrate the enforcement of the applicable State statutes.

This Court has never expressly held that ordinary and necessary expenses are not deductible because the deduction may tend to frustrate sharply defined national or State policies. In the case of *Lilly* vs. *Commissioner*, 343 U.S. 90, 72 S. Ct. 497, this Court, in discussing the Heininger case, stated:

> "Neither that decision nor the rule suggested by it requires disallowance of petitioners' expenditures as deductions in the instant case.
>
> Assuming for the sake of argument that, under some circumstances, business expenditures which are ordinary and necessary in the generally accepted meanings of those words may not be deductible as "ordinary and necessary" expenses under 23(a)(1)(A) when they "frustrate sharply defined national or state policies proscribing particular types of conduct, supra, nevertheless the expenditures now before us do not fall in that class."

It is the insistence of Petitioner here that the ruling of the Court in the Lilly case is equally applicable here.

Conclusion

Petitioner most respectfully insists that the Federal Revenue statute is a revenue producing statute and not a policing statute, and the particular wording of State statutes should have no bearing whatever on the deductibility of unavoidable business expenses, otherwise the Revenue Act would of necessity be construed differently in different States.

The expenses involved in this case are just as ordinary and necessary in this particular business as is the purchase of gasoline or the payment of wages to the employees, and

Congress did not intend to deny the deduction of such expense items merely because a State has seen fit to denominate them as fines or penalties.

Petitioner, therefore, respectfully insists that the lower Courts should be reversed.

Respectfully submitted,

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